No. 76-226

# In the Supreme Court of the United States

OCTOBER TERM, 1976

In Re CRATEO, INC.,

Bankrupt,

CRATEO, INC.,

Petitioner,

v.

INTERMARK, INC., et al.,

Respondent.

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## REBUTTAL BRIEF CALLING ATTENTION TO FACTUAL ERRORS IN RESPONDENTS' BRIEF

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## TABLE OF AUTHORITIES

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Petitioner respectfully directs the Court's attention to four erroneous statements in the Opposition Brief of Respondents:

(1)

Respondents, on page 9 of their Brief, asserted that the portion of the decision of the Ninth Circuit which "imposed" duties upon directors and "deprived" shareholders of rights, was not raised below. That assertion is incorrect.

The Ninth Circuit in its opinion failed to discuss the serious constitutional issues which arise from converting directors

into trustees for creditors, such as (1) imposing fiduciary duties to creditors upon the directors without "due process"; (2) forcing directors into the involuntary servitude of creditors, (3) depriving shareholders of control of the corporation without "due process"; (4) denying creditors their statutory right to select a trustee as provided by Section 44 of the Bankruptcy Act; and (5) placing directors in civil jeopardy for violating State law.

Those matters were all extensively briefed to the Ninth Circuit as set forth in Item (1) of the Appendix.

(2)

Respondents, on page 12 of their Brief, dealing with the need for a disinterested receiver, stated that "Crateo did not raise this argument in the Courts below." That statement is incorrect.

The requirement of a disinterested receiver or trustee was extensively briefed to the Ninth Circuit as is set forth in Item (2) of the Appendix.

The point, of course, is that the Ninth Circuit did not discuss the requirement of a disinterested trustee, but by holding that Crateo's actions in the State Court resulted in the "appointment of a receiver or trustee" it, in effect, stated that Crateo's directors (notwithstanding that they were adverse to creditors) became trustees for creditors.

This places the Ninth Circuit in conflict with both California Statute and the Eighth Circuit on the need for a disinterested trustee.



(3)

Respondents stated relative to the fraudulent Texas judgment on page 13 of its Opposition Brief that "Crateo could not explain satisfactorily the reason for its delay of two and one-half years in raising the issue of the use of alleged extrinsic fraud in procuring the judgment."

The answer to that is that Crateo simply did not know of the fraud. As soon as it discovered the fraud it made motions to perpetrate testimony, and to set aside the judgment on grounds of newly discovered evidence. There was a time lag of only 12 days from the time of discovery of the fraud to the time of calling that discovery to the Court's attention, and a portion of that 12 days involved the Christmas holidays. You can't inform someone of a fraud until you first know about it.

This matter was presented in extensive fashion in two motions to the Trial Court and in two appeals to the Ninth Circuit. Please refer to Item (3) of the Appendix.

(4)

Petitioner pointed out it was not required to attack the Texas judgment in the Texas rendering Court, but, rather, that since the fraud of concealment was also committed in the Court below, that fraud could be attacked in the Court below.

Respondents, on page 13 of their Brief, incorrectly asserted this point was not raised below. In fact, it was extensively briefed before the Ninth Circuit. The Ninth Circuit itself devoted four paragraphs to this matter (pages A-12 to 13 of Petitioner's Petition). Item (4) of the Appendix recites portions of the Briefs below.

The point, of course, is that Respondents are attempting to profit from the fraud of another by utilizing that fraud to make up 40% of the claimed debt which Crateo was supposedly unable to pay as it matured.

## CONCLUSION

Petitioner respectfully requests this Honorable Court to disregard the incorrect statements of Respondents and to grant Certiorari to resolve the multiple conflicts among the various circuits as set forth in its Petition.

Respectfully submitted,

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MURRY LUFTIG
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# APPENDIX

(1)

*The Serious Constitutional Problems Involved in Converting Directors into Trustees for Creditors were Briefed Below.*

Crateo, in its "Apppellants Opening Brief" No. 74-2615, pages 31-34, specifically called the Court's attention to the following:

> "This Brief shows there are also constitutional problems affecting Directors, Shareholders and Creditors which will arise from the attempt to convert Directors into Trustees for Creditors by interpreting Section 3a(5) of the Bankruptcy Act to change the clear meaning of the California Corporations Code.
>
> "The California Statute specifically provides that Directors continue to act as Directors:
>
> > 'Where voluntary proceedings for Winding Up of Dissolution of a Corporation have been commenced, the *Board of Directors shall continue to act as a Board*. . . .' (Cal. Corp. Code Sec. 4800.)
>
> "Intermark and the other petitioning creditors argue that filing the voluntary proceedings for dissolution converted the directors into 'Receivers or Trustees for Creditors' by virtue of Section 3a(5) of the Bankruptcy Act.
>
> . . .

"In other words the federal code section was used by the creditors and the Court below to cast a totally different meaning upon a California Statute.

"This usage or interpretation of the federal statute 3a(5) would render that statute unconstitutional for the following reasons:

. . .

"(b) *Fiduciary duties to creditors would be imposed upon Directors without "due process."*

"Under Intermark's thesis Bankruptcy Section 3a(5) alters the California Corporations Code relative to Directors and the Directors owe a 'fiduciary duty' to the creditors forthwith upon filing the voluntary dissolution proceedings. Yet, clearly, the Directors accepted no such fiduciary duty to creditors. To interpret Section 3a(5) as foisting a 'fiduciary duty to creditors' upon the Directors contrary to the Directors' wishes and without notice and hearing, violates the 'due process' required by the 14th Amendment to the Constitution.

"(c) *The obligation of contract between the Directors and Shareholders would be impaired.*

"The Intermark thesis of using 3a(5) to convert directors into receivers for creditors would cause Section 3a(5) to be used to impair the obligation of the contract between the directors



and shareholders in violation of Article I, Section 10 of the U. S. Constitution and Article I, Section 16 of the California Constitution. The shareholders have never consented to have their elected Directors act as servants of creditors.

"(d) *Shareholders would be deprived of control of the Corporation without 'due process of law.'*

"To interpret Section 3a(5) to mean that the Directors of Crateo are converted into Trustees for creditors on filing of dissolution proceedings would deprive the shareholders of their control over the corporation and to that extent deny them of their property rights without 'due process of law' and violate the 14th Amendment to the U. S. Constitution.

"(e) *Violates law of common sense.*

"In addition to violating the Federal and State Constitutions, it violates the 'law of common sense' to interpret 3a(5) to change the meaning of the California Corporations Code to convert Directors into Trustees for Creditors.

"The shareholders and their representatives, the Directors, want to minimize or eliminate the creditors' claims; the creditors, on the contrary, want to maximize their claims. The Directors under California Corporations Code Section 4801 must 'defend suits brought against the

corporation.' To require the Directors to act in the best interests of creditors flouts every concept against 'conflict of interest' that is known in the law.

. . ."

(2)

*The Requirement that the Trustee be "Disinterested" was Raised Below.*

Crateo raised the point of the need for a disinterested Trustee in its Opening Brief to the Ninth Circuit, #73-3208, pages 8-12. It stated in that brief, in relevant part:

"As already discussed, under California corporate law, the directors remain directors of the corporation, they do not become trustees, and the application of *Bonnie* is, accordingly, improper.

"The Court in *Blair*, also furnishes guidance with respect to the definition of 'receiver' or 'trustee.' The court in *Blair* described a receiver as follows:

'A receiver is an indifferent person between the parties to a cause, appointed by the court to receive and preserve the property or fund in litigation pendente lite, when it does not seem reasonable to the court that either party should hold it. He is not the agent or representative of either party to the action, but is uniformly regarded as an officer of the court. . . .' 471 F.2d at 181.



"Crateo's directors do not fall within this definition. They continue to owe their duty to the corporation and retain the discretion to continue the corporation's business as they deem appropriate."

(References are to *In Re Bonnie Classics* 116 F.Supp. 646 (S.D.N.Y. 1953) and *Blair & Co., Inc. v. Foley* 471 F.2d 178 (1972).)

In Appellant's Opening Brief before the Ninth Circuit #74-2615, Crateo again pointed out the California requirement for a disinterested person:

"Under the laws of the State of California . . . California Code of Civil Procedure Section 565 provides that upon dissolution of any corporation the Superior Court may appoint one or more persons to be receivers or trustees of the corporation, but Section 566, immediately following thereafter, declares that:

'*No party* or attorney of a party, or a person interested in an action, or related to any judge of the court by any consanguinity or affinity within the third degree, can be appointed receiver therein without the written consent of the parties filed with the Clerk.'

(California Code of Civil Procedure Section 566)

In Appellant's Opening Brief to the Ninth Circuit #74-2615, a comparison of the attributes of Receiver/Trustee with that of Directors, was made. The following specifically deal with the requirement of disinterest:

| "Receiver/Trustee | Directors |
|---|---|
| "Trustee elected by creditors. (The alleged *Bankrupt, its officers and directors may not vote.*) Receiver appointed by Court. | Elected by Shareholders. (Cal.Corporations Code 4803.) |
| Creditors nominate Receiver and Trustee. (The alleged *bankrupt, its officers and directors may not nominate.*) | Shareholders nominate the directors. |
| Prospective Receiver/ Trustee must be shown prior to appointment to be *free from allegiance adverse to general creditors.* | Directors have a definite bias in favor of shareholders. |
| Receiver hires attorney, normally with permission of Court. Attorney owes allegiance to creditors. Full disclosure of adverse interests of attorney required. *Attorney for Corporation is barred from employment.* | Directors hire their own attorney. Attorney owes allegiance to Corporation and its Shareholders. (Cal. Corporations Code 4801.) |



| | |
|---|---|
| Referee or Trustee is required to affirmatively furnish any information which indicates a bankruptcy offense has been committed. | Directors owe fiduciary duty to Shareholders not to improve the case for the creditors. |
| If a Receiver or Trustee has an interest adverse to the creditors it may be a bankruptcy crime. | Directors (who are often also shareholders) represent shareholders and have interest adverse to creditors. " |

Appellant's Brief #74-2615. (Italics added) Pages 34-35.

(3)

***Crateo Called the Court's Attention to the Fraud as soon as it Discovered it.***

Petitioner (Appellants) Opening Brief to the Ninth Circuit in Case #74-2088 devoted 21 pages to the fraud and its discovery. It included photostatic copies of the forged signatures and the report of the Examiner of questioned documents which the Nevada Court had before it.

The Affidavit dealing with the discovery of the fraud was filed with the U. S. District Court, Southern District of California (Trial Court) on January 30, 1974, coupled with a motion to perpetuate testimony. This was only 12 days after "discovery" and included the Christmas holidays. The Affidavit stated in relevant part:

"On the 18th of December 1973, affiant had a telephone conversation with Mr. Jack Donnelly, Attorney at Law, 2655 Fourth Avenue, San Diego, California, Attorney Donnelly represented and now represents the Estate of Wilbur Clark, Deceased, and Toni Clark, the widow of Wilbur Clark. In the course of this conversation Attorney Donnelly informed your affiant that the note in the face amount of $780,000.00, bore the signature of a purported maker of that note, one Toni Clark, and that handwriting experts for both the bank (that is, the Southern National Bank of Houston) and Toni Clark agreed that the signature was a forgery. . ."

"That the information received from Attorney Jack Donnelly as hereinbefore set forth refers to that certain promissory note in a face amount of $780,000.00 executed by or guaranteed by Wilbur Clark and Toni Clark, Clayton Blakeway, Mrs. Clayton Blakeway, William Ward, III, and Mrs. William Ward, and secured by a second deed on a hotel in Austin, Texas. Toni Clark was a maker of that promissory note. That Referee Fox, acting as a Master in the within matter, in finding of fact No. 2 in the Fourth Report filed found that Crateo, Inc. had "debts" totaling $750,621.56. That the 'purported debt' of Southern National Bank of Houston constituted $293,647.61, or approximately 40% of this total debt."



In its Petition for Rehearing filed June 10, 1976, Crateo pointed out to the Ninth Circuit:

"5. THE COURT ERRS IN ASSUMING THAT THE APPELLANT COULD OR SHOULD HAVE DISCOVERED THE MATTER SOONER.

"The knowledge of the forgery was discovered after the trial, as was the decree establishing it.

"An affidavit of WALTER WENCKE, filed in the District Court, in connection with the post-judgment motions, and unrefuted, establishes the manner in which the information came to light. It came in a telephone call on December 18, 1973, after the trial. Since the charge here is concealment from the Courts of the judgment establishing the forgery, it is no answer to say the concealment was successful." (Petition for Rehearing, page 11) Nos. 73-3208, 74-2088, 74-2615, 75-3061.

(4)

*The Right of the Court Below to Attack the Concealment Practiced Upon it was Briefed Below.*

Petitioner, in its Reply Brief in Case #74-2615, filed January 16, 1975, in the Court below, asserted:

"1. <u>This Court has the Inherent Power to Exclude 'Rotten Fish' Claims</u>.

"Appellees argue in Point 1 of their response that the fraud tainted judgment by the Southern National Bank of Houston against Crateo is not subject to collateral attack in these proceedings. Instead they argue it should be set aside in Texas." (page 7)

"If the fraud of the Bank is patently evident and the nondisclosure of the fraud took place before this Court, why should this Court require a circuitous and time consuming procedure in Texas before it simply disregards the fraud?" (page 9)

"III. Appellees also do not discuss the fact that the concealment of the second judgment took place in the Court below.

"We point out, as we have in previous Briefs, that the fraud of concealment of the forgery after it was known, took place in San Diego, in the U. S. District Court. The Order of Judge Turrentine appointing Mr. Holzman as a Receiver (found as an exhibit in Appellants Opening Brief in 74-2615) recites in the preamble as among those present 'John M. Seitman of Seales, Patton, Ellsworth & Corbet (sic) for Southern National Bank of Houston'. The agents for the Bank, present in Court at the time of the Order, were silent when they should have spoken.

"The only thing that this Honorable Court is requested to do is recognize the fraud tainted judgment for what



it is - fraud; and deny to Appellees the benefits of that fraud.

"Let me give an example:

"A, B, & C put fish into a scale. D is to pay cash for those three fish. A's fish is rotten. We see the rottenness and smell the foulness of A's fish. The Bankruptcy Court determines that D is bankrupt because of the value of those three fish.

"Appellees, Intermark et al., are arguing the weight of those fish, including the rotten stinking fish, should be used to determine the dollar value of the creditors.

"We are simply arguing that this Court has a common sense duty to recognize the rotten fish *before* it, and that people don't pay for rotten, stinking fish. (page 9)

"SUMMING UP:

"1. Appellees are coming up with a theoretical legal position that someone must first go to Texas to get a Court Order in Texas setting aside a fraud which has already been demonstrated and adjudicated in Nevada.

"2. This argument ignores the quagmire of practical and legal problems that such a position would create (i.e. - who are the Receivers, who initiates, who controls, what is the source of funds, etc.)

"3. Appellees position is that they can avail themselves of the fruit of fraud until someone goes through the quagmire of these problems. They want "rotten fish" to be weighed in determining liabilities.

"4. When fraud is proved in Nevada, on a forgery not known to exist at the time of an earlier judgment in Texas, then this Court has the inherent right to disregard that earlier judgment and accept the second judgment in which the fraud was discovered as the 'res judicata' judgment.

"5. Further, when the 'nondisclosure' of the fraud takes place in the Court below, that 'act of silence,' when one should have spoken, is within the purview of this Court." (page 10)